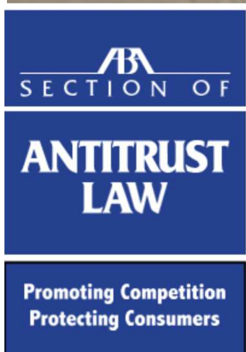
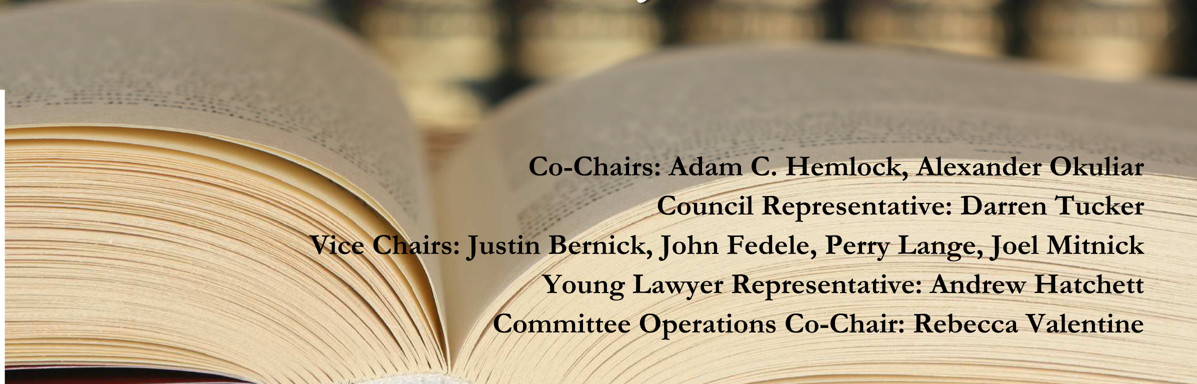
Cartel & Joint Conduct Review

Newsletter of the ABA Section of Antitrust Law Joint Conduct Committee





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Message from the Editors

by Joel Mitnick and Mark G. Weiss

Welcome to the Spring 2020 Edition of the *Cartel & Joint Conduct Review.* This issue covers the evolving landscape of joint conduct developments, including a high-profile interview of one of DOJ's top criminal enforcers and meaningful discussion of many antitrust hot topics including private equity and antitrust, the economics of no-poach agreements, and high-tech issues including platforms, privacy, and standardization.

Joel Mitnick interviews Antitrust Division's Deputy Assistant Attorney General for Criminal Enforcement Richard Powers about the scope and direction of criminal prosecutions, including the Heir Location investigation, deferred prosecution agreements, and the new government procurement strike force. Kevin Goldstein and Anora Wang discuss conspiracy claims under Section 1 of the Sherman Act, as recently raised against private equity firms. Nick Dadson, Jee-Yeon Lehmann, and Samuel Weglein provide the approach of economists to analyzing vertical restraints in labor markets. Joel Mitnick and Ngoc Pham Hulbig address whether effects on data privacy are cognizable under the Sherman Act and the FTC Act. And, for a global perspective, Gabriel Araújo Souto investigates the American and European approaches to standardization and the Internet of Things.

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When Private Equity Firms Face U.S. Antitrust Liability for Portfolio Company Conduct

By Kevin B. Goldstein and Anora Wang

Mr. Goldstein is an associate and Ms. Wang is an associate at Winston & Strawn LLP, where their practices focus on antitrust matters.

In multiple recent litigations, private equity (PE) firms have faced antitrust conspiracy claims under Section 1 of the Sherman Act arising—at least primarily—out of alleged anticompetitive conduct by their portfolio companies, rather than the PE firms themselves. These cases raise important questions for PE firms and their lawyers to consider as they evaluate risks from portfolio company operations and structure their investment and management relationships. This article discusses rulings from two recent cases—*In re Packaged Seafood Products Antitrust Litigation* and *In re Liquid Aluminum Sulfate Antitrust Litigation*—and the standards courts applied to determine whether a PE parent had liability based on portfolio company conduct.

It is clear that if a PE firm is actively participating in an antitrust conspiracy, then it will face liability. For example, in cartel cases, if PE partners or employees are attending cartel meetings on behalf of their firm and entering into price-fixing agreements with a portfolio company's competitor (or the competitor's parent), the PE parent can expect to be treated as any other conspirator. But what happens when the PE parent is not at the cartel meeting and is not a party to any agreement with a competitor? In cases where evidence ties only a portfolio company directly to an antitrust violation, but does not show direct participation by the PE parent, evaluating the parent's potential antitrust liability depends heavily on the details of the PE-portfolio company relationship.

In assessing the relationship between a PE firm and its portfolio company, a useful starting point is the Supreme Court cases that have laid out the fundamental principles of "corporate separateness"—that a parent corporation and its subsidiary are separate corporate forms[1]; and that the rule of corporate separateness "insulates a parent corporation from liability created by its subsidiary, notwithstanding the parent's ownership of the subsidiary."[2] As in a typical parent-subsidiary relationship, a PE firm should enjoy the presumption of corporate separateness that is only to be overcome by allegations of sufficient facts tending to show otherwise.

A claim seeking to impose antitrust liability on a PE parent for acts by its portfolio company is essentially asking the court to "pierce the corporate veil," a legal concept where entities' separate corporate forms are disregarded in limited, extreme circumstances.[3] The

[1] *Dole Food Co. v. Patrickson*, 538 U.S. 468, 474 (2003).

[2] *United States v. Bestfoods*, 524 U.S. 51, 61 (1998).

[3] Various circuit have held that the corporate veil may be pierced only in limited circumstances. *See, e.g., Doe v. Unocal Corp.*, 248 F.3d 915, 926 (9th Cir. 2001) (per curiam), *abrogated on other grounds by Daimler AG v. Bauman*, 571 U.S. 117 (2014).

federal antitrust laws, unlike some other federal statutes, do not contain statutory guidelines on when the corporate veil can be pierced, when to disregard the corporate form, or when to apply relevant state law on this issue.[4] Courts have recognized that corporate-veil-piercing is *context specific* and *purpose specific*, meaning that a pierced corporate veil in one situation might still remain intact in a different situation.[5] Therefore, it is understandably difficult for courts to articulate a generalized rule, even if only for the specific PE parent-portfolio company relationship, or only for violations of federal antitrust laws.

Without a separate framework for antitrust cases, courts have analyzed PE-portfolio relationships under the same legal frameworks used to evaluate potential parental liability in parent-subsidiary relationships in a variety of other contexts.[6] This includes asking (1) whether the portfolio company is an alter ego of the PE firm; (2) whether the portfolio company is merely an agent of the PE firm in its act violating the antitrust laws; or (3) if the challenged conduct involves individuals who hold positions in both the PE firm and the portfolio company. However, the cases demonstrate that some of these considerations are more relevant than others in the PE context.

Theories of alter ego, agency, and vicarious liability have been argued and considered in two recent district court cases, which demonstrate that courts are generally reluctant to "pierce the corporate veil" at the motion to dismiss stage, but are willing to let antitrust claims go forward against PE firms where there is at least some allegation of the PE firm's direct participation in the alleged antitrust violation.

I. Theories Recently Tested in District Courts

Two recent cases tested how district courts evaluate theories of agency and vicarious liability at the motion to dismiss stage in deciding whether a PE firm can face antitrust liability for conduct by its portfolio company. In both cases, courts denied the motions to dismiss as to those defendants that they found were sufficiently alleged to have *directly* participated in a conspiracy. Yet, in the absence of finding sufficient allegations of direct participation, one court went on to consider and reject various theories of vicarious liability, ultimately dismissing all claims against the PE parent.

In *In re Liquid Aluminum Sulfate Antitrust Litigation*, the U.S. District Court for the District of New Jersey denied a PE defendant's motion to dismiss, holding that inquiries into the plaintiff's theory of liability based on the PE firm's ownership of the portfolio company would be more appropriate for a later stage such as for summary judgment.[7] However, because the court found the alleged facts sufficient to subject the PE firm to potential liability for *direct* involvement in the alleged conspiracy, it's unclear whether the court would have let the ownership-based theory of liability survive the motion to dismiss on its own.

Then in *In re Packaged Seafood Products Antitrust Litigation*, the U.S. District Court for the Southern District of California, dealing with allegations of tuna price-fixing, considered motions to dismiss by a British PE firm, its U.S. subsidiary, and a related holding company that were invested in the Bumble Bee tuna company. There, the court found that the alleged facts failed to show two of

[4] *See e.g.*, Fair Labor Standards Act § 3(r), 29 U.S.C. § 203(r) (1976) (single-enterprise standard); ERISA § 4001(b), 29 U.S.C.A. § 1301(b)(1) (West Supp. 1981) (common control standard); Federal Tort Claims Act, 28 U.S.C. §§ 1346(b), 2672, 2674 (1976).

[5] *See e.g.*, *In re Sugar Indus. Antitrust Litig.*, 579 F.2d 13, 18-19 (1978) ("After considering all of the facts in this case, we conclude that, *at least for this purpose and in this context*, the subsidiary should be treated as the alter ego of the parent." (emphasis added)).

[6] This article generally assumes that the PE firm's ownership and control of the portfolio company is uncontested. In situations where a PE firm owns only a portion of the portfolio company or otherwise lacks control, additional considerations would apply.

[7] *City of Greensboro v. Am. Sec., LLC* (*In re Liquid Aluminum Sulfate Antitrust Litig.*), 2018 U.S. Dist. LEXIS 16577, *38, 2018 WL 658691.

the PE entities' direct involvement in the alleged price-fixing conspiracy. The court went on to reject the plaintiffs' "alter ego theory"— that attempted, among other things, to impute acts of the portfolio company to the PE investors—for failure to allege an "unity of interest." The court also rejected the plaintiffs' "agency theory"[8] and "vicarious liability theory" (involving dual officers) when the plaintiffs failed to overcome a presumption that "the directors are wearing their 'subsidiary hats' and not their 'parent hats' when acting for the subsidiary."[9]

A. In re Liquid Aluminum Sulfate Antitrust Litigation (D.N.J. 2018)

In *Liquid Aluminum Sulfate*, a PE firm that owned entities running a water chemical business, and two individuals working for the PE firm as managing directors, among others, were named as defendants in antitrust litigation concerning alleged collusion to allocate customers and/or fix the price of a water treatment chemical, liquid aluminum sulfate, known as "Alum." The PE firm and its two managing directors (the "PE defendants") filed motions to dismiss in the district court, which the court denied on February 1, 2018. In 2019, the PE firm agreed to pay $13 million to settle the antitrust claims against it.[10]

In their motions to dismiss, the PE defendants argued that their "mere ownership" of the portfolio company was "insufficient to subject them to liability" for the portfolio company's alleged antitrust violation.[11] The court rejected this argument with minimal discussion, citing two reasons. First, the court found that the complaint allegations included "numerous specific examples" that, if found to be true, could make the PE defendants liable for having directly participated in the alleged conspiracy.[12] Second, which is important for its implications, was that "[s]uch an argument seems to be more appropriate for the summary judgment phase of the case and not the motion to dismiss phase."[13]

There, the allegations pertaining to the PE firm's direct involvement included that the PE defendants (1) reviewed and authorized significant Alum bids, (2) oversaw the portfolio company's announced intent to increase prices in the market, (3) required that all bids by the portfolio company over a certain amount be approved by the PE firm, where the approved price was determined by whether the portfolio company was "predestined to win" or submitting an intentionally losing "throw-away" bid, and (4) requested monthly reports in order to monitor the conspiracy.[14]

As the *Liquid Aluminum Sulfate* case shows, when a court considers plaintiffs' allegations of the PE firm's direct involvement in the conspiracy sufficient to move the case to a next phase, it may opt to preserve the plaintiffs' ownership-based theory of liability as well without detailed analysis of when to disregard the basic rule of corporate separateness.

B. In Re Packaged Seafood Products Antitrust Litigation (S.D. Cal. 2020)

In *Packaged Seafood Products*, three PE-related entities—a British PE firm, its subsidiary U.S. PE firm, and a related Cayman Islands holding company that ultimately held the assets of the portfolio company Bumble Bee, a packaged seafood manufacturer—among others, were named as defendants in litigation alleging a conspiracy to fix prices of packaged seafood throughout the United States.

The claims went through two rounds of motion to dismiss briefing and rulings.

In the first ruling, on September 5, 2018 (the "2018 order"), the court denied a motion to dismiss as to one of

[8] *In re Packaged Seafood Prods. Antitrust Litig.*, No. 3:15-md-02670-JLS-MDD (S.D. Cal. Jan. 28, 2020) (ECF No. 2270) (order granting defendants' motion to dismiss), at 15.

[9] *Id.* at 16 ((*citing Bestfoods*, 524 U.S. 51 (1998)).

[10] *In re Liquid Aluminum Sulfate Antitrust Litigation*, No. 2:16-md-02687-JLL-JAD (D.N.J. May 13, 2019) (ECF No. 1293) (order granting preliminary approval of proposed settlement).

[11] *In re Liquid Aluminum Sulfate Antitrust Litig.*, at *38-39.

[12] *Id.* at *32.

[13] *Id.* at *38.

[14] *Id.* at *31-32.

the three PE defendants (the U.S. entity), but dismissed the parent British entity and the Cayman Islands holding company.[15] The court's partial denial of the motion to dismiss was based on its finding that the complaint "plausibly demonstrates [the U.S. PE entity] directly participated in the ongoing conspiracy."[16] By contrast, the court found insufficient allegations that the British or Cayman Islands defendants directly participated in the alleged conspiracy or that the U.S. PE entity or portfolio company were alter egos of them.[17]

Subsequently, the plaintiffs amended their complaints against the British PE firm and the Cayman Islands holding company, and the two defendants again filed a joint motion to dismiss for lack of personal jurisdiction and for failure to state a claim. The court granted the defendants' motion on January 28, 2020 (the "2020 Order").[18] In the 2020 Order, the court's analysis addressed claims based on theories of "*agency*" and "*vicarious liability*."

The following summarizes the court's relevant analysis from both the 2018 Order and 2020 Order.

1. *Alter Ego Liability Theory*

As addressed in the 2018 Order, the plaintiffs initially relied on an alter ego theory to support both their arguments for antitrust claims and for exercise of personal jurisdiction over the British PE firm and the Cayman Islands holding company. Because the court considered the parties' alter ego arguments on both issues to be "co-extensive," it addressed the theory at length in its analysis of personal jurisdiction, and then largely incorporated that same discussion for its analysis of the antitrust claims.[19]

In its discussion of personal jurisdiction, the district court laid out the Ninth Circuit's alter ego test to exercise jurisdiction on a parent by imputing the subsidiary's contacts with the forum:

> To satisfy the alter ego exception, the plaintiff must demonstrate "(1) that there is such unity of interest and ownership that the separate personalities [of the two entities] no longer exist and (2) that failure to disregard [their separate identities] would result in fraud or injustice."

2018 Order at 1143 (*citing Unocal*, 248 F.3d at 926 (alterations in original).

As between the British PE firm and the portfolio company, the defendants first argued that, as a threshold matter, alter ego liability was foreclosed because the former did not directly own the latter. The court responded that actual/direct ownership is not a prerequisite for an alter ego theory, as "equitable ownership might be sufficient in some contexts."[20]

In analyzing whether a PE firm has "equitable ownership"

[15] *In re Packaged Seafood Prods. Antitrust Litig.*, 338 F. Supp. 3d 1118, 1186 (S.D. Cal. Sep. 5, 2018) [hereinafter, 2018 Order].

[16] *Id.* at 1180. Here, the court cited allegations that included (1) the U.S. PE firm was subject to an ongoing DOJ inquiry where the portfolio company had already pled guilty to price fixing; (2) the PE firm had knowledge of the market dynamics that should have caused it to "diagnose why prices remained elevated despite decreasing demand and increasing supply; (3) a telephone conversation involving a dual officer of the British PE firm and its subsidiary U.S. firm that discussed non-public price list information; and (4) emails between dual officers of the British PE firm and its subsidiary U.S. firm discussing actions to show public support of price increase. *Id.* at 1180-82.

[17] *See id.* at 1155, 1174. While some allegations implicating the U.S. PE entity might also have implicated the British or Cayman Islands entities, the court found that the plaintiffs had "impermissibly engaged in group pleading without differentiating between who was employed by what entity" and deemed the allegations insufficient as to those two entities. *Id.* at 1184.

[18] *In re Packaged Seafood Prods. Antitrust Litig.*, No. 3:15-md-02670-JLS-MDD (S.D. Cal. Jan. 28, 2020) (ECF No. 2270) (order granting defendants' motion to dismiss) [hereinafter, 2020 Order].

[19] 2018 Order, 338 F. Supp. 3d 1174.

[20] *Id.* at 1149 (*citing* In re Schwarzkopf, 626 F.3d 1032, 1038 (9th Cir. 2010)).

of a portfolio company that was separated by several layers of controlling entities, the court cited precedent that owning no shares was not dispositive if sufficient facts existed to demonstrate that one "acted as owner" of the other;[21] and that equitable ownership existed where "business activities are effectively controlled by its managing agent and attorney-in- fact."[22] The court found that the British PE firm had equitable ownership of the portfolio company, considering facts showing (1) the British PE firm exercised control and directed the investment of the fund that ultimately owned the portfolio company; (2) the British PE firm executives themselves seemed to think they owned the portfolio company; and (3) the portfolio company, in its criminal plea agreement with the Department of Justice, included the British PE firm as a "parent company."[23]

After having satisfied itself that the British PE firm had sufficient equitable ownership of the portfolio company, the court then moved on to analyze their "unity of interest" under the alter ego test. Following the Ninth Circuit precedents *Doe v. Unocal Corp* and *Ranza v. Nike, Inc.*, the court stated that "[t]he unity of interest element requires 'a showing that the parent controls the subsidiary to such a degree as to render the latter the mere instrumentality of the former.'"[24] Focusing on "control,"[25] the court turned to the cases as cited in *Unocal* to guide its inquiry.

Specifically, the court cited situations as sufficient to show unity of interest and appropriate for corporate veil piercing where: (1) the parent uses its subsidiary as a "marketing conduit" and tries to shield liability arising from the subsidiary's activities;[26] (2) the parent directs every facet of the subsidiary from broad policy decisions to routine matters of day-to-day operations.[27] Conversely, merely showing the following would be *insufficient* to show an unity of interest:

> (1) involvement in its subsidiaries' acquisitions, divestments and capital expenditures; (2) formulation of general business policies and strategies applicable to its subsidiaries, including specialization in particular areas of commerce; (3) provision of loans and other types of financing to subsidiaries; (4) maintenance of overlapping directors and officers with its subsidiaries; and (5) alleged undercapitalization of its subsidiaries.

2018 Order, at 25 (citing *Unocal*, 248 F.3d at 927).

Applying these principles to the relationship the British PE firm and the portfolio company, the court found that the plaintiffs' evidence fell short of alleging a unity of interest, because (1) merely receiving information and providing input on business decisions did not reach the level of active involvement to overcome the observance of corporate formalities;[28] (2) the fact that the British PE firm placed directors on the portfolio company's board, by itself, is not dispositive;[29] and (3) the facts pertaining to the British PE firm's placement of a large debt on the portfolio company (e.g., increasing debt-to-capital ratio from 60% to 90%) did not reach the level of pervasive undercapitalization required to demonstrate unity of

[21] *Id.* at 1150 (*discussing* Tatung Co. v. Shu Tze Hsu, 217 F. Supp. 3d 1138, 1178 (C.D. Cal. 2016)).

[22] *Id.* (*discussing* Troyk v. Farmers Grp., Inc., 171 Cal. App. 4th 1305, 1343 (Ct. App. 2009)), *as cited in Schwarzkopf*, 626 F.3d 1032, 1039 (9th Cir. 2010)).

[23] With regard to the last fact, the court reasoned that even if the term "parent companies" were not defined, it indicated at least "some modicum of control" of the portfolio company by the PE firm. *See id.*

[24] *Id.* at 1145 (*citing* Ranza v. Nike, Inc., 793 F.3d 1059, 1073 (9th Cir. 2015) (*quoting Unocal*, 248 F.3d at 926).

[25] For a more extensive discussion on courts' analysis of "control" in the joint conduct context, see generally James Keyte & Kenneth Schwartz, Private Equity and Antitrust: A New Landscape, ANTITRUST (Fall 2016) 21 (differentiating having "legal control" as evidenced in economic interest and voting rights and having actual con- trol through requirement of approval for certain actions and sitting on board).

[26] 2018 Order,at 1145 (*citing Unocal*, 248 F.3d at 926 (*quoting* United States v. Toyota Motor Corp., 561 F. Supp. 354, 359 (C.D. Cal. 1983)).

[27] *Id.* (*citing Unocal*, 248 F.3d at 926–27 (*quoting Rollins Burdick Hunter of S. Cal., Inc. v. Alexander & Alexander Servs., Inc.*, 206 Cal. App. 3d 1, 11 (Ct. App. 1988)).

[28] *Id.* at 1153.

[29] *Id.* at 1154.

interest.[30] Having concluded that the plaintiffs did not allege "unity of interest," the court ruled that the plaintiffs' "alter ego" theory failed for jurisdiction as well as liability.

2. *Agency and Vicarious Liability Theories*

In the 2020 order, the *Packaged Seafood Products* court addressed the British PE firm's and the Cayman Islands company's motion to dismiss claims in the amended complaint alleging liability under theories of "agency" and "vicarious liability."[31] While the plaintiffs made another attempt to allege *direct* participation in the conspiracy by the PE firm and the holding company, the court found no new plausible allegations on this ground.

In their remaining theories, the plaintiffs argued that the British PE firm should be liable because (1) the U.S. PE firm subsidiary was merely an agent of the British PE firm, and (2) employees of the U.S. subsidiary involved in the alleged anticompetitive acts also held positions at the British PE parent ("dual officers").[32] The court's analysis focused significantly on the allegations related to dual officers.

The court began its agency analysis under federal common law principles of agency,[33] and looked to the general test set out in the Restatement of Agency:[34] However, focusing on the allegations related to dual officers, the court further framed its analysis under the Supreme Court's hold in *United States v. Bestfoods*, which established that "when alleging liability for a parent corporation based on the actions of an employee of both the subsidiary and the parent corporation, the party alleging liability must plead facts showing that the employee was acting within his or her capacity as an employee of the parent corporation and not the subsidiary."[35] "Otherwise, courts 'generally presume that the directors are wearing their 'subsidiary hats' and not their 'parent hats' when acting for the subsidiary.'"[36]

Relying upon this *Bestfoods* presumption, the court went on to find that, although the complaint contained allegations of anticompetitive acts undertaken by certain dual officers of both the British PE firm and its subsidiary U.S. PE entity, plaintiffs had failed to plead sufficient facts that those employees were acting on behalf of the parent British PE firm and not the subsidiary.[37] The court also gave particular weight to the defendants' contention that the dual officers were acting in their capacity as employees of the U.S. PE entity because it was consistent with the overall corporate function of that U.S. entity, which had been tasked by the parent with oversight of the Bumble Bee portfolio company.

Thus, the court rejected the plaintiffs' theories of agency, as well as vicarious liability, when they failed to provide extra facts to overcome the presumption that the individual was acting in the subsidiary capacity.

II. CONCLUSION

There is no separate statutory rule for courts to assess whether the relationship between a PE firm and a portfolio company justifies imposing liability on the PE firm for alleged antitrust violations by the portfolio company. However, all analyses start from the same presumption of respecting the corporate forms as they exist separately, and attaching liability on the parent only in limited and extreme cases, where "piercing the corporate veil" is warranted. In conducting this analysis,

[30] *Id.*

[31] The plaintiffs also made a futile attempt to raise a "representative service doc- trine" that the court summarily addressed as a non-viable theory for imposing liabil- ity. *See* 2020 Order, at 17 ("The Court has been unable to find, and Plain- tiffs have failed to provide, a single case in which any court has found liability for a parent corporation based on the representative services doctrine.").

[32] *Id.* at 7-9.

[33] *Id.* at 15. The parties did not dispute that federal common law was applicable.

[34] "[A] plaintiff must demonstrate: (1) a manifestation by the principal that the agent shall act for him; (2) that the agent has accepted the undertaking; and (3) that there is an understanding between the parties that the principal is to be in control of the undertaking." *Id.* (*citing* Restatement (Third) of Agency,§ 1.01).

[35] *Id.* at 16 (*discussing Bestfoods*, 524 U.S. 51, 69-70 (1998)).

[36] *Id.*

[37] *Id.*

courts make fact-intensive inquiries of the relation between a PE firm and portfolio companies in order to arrive at a context specific and purpose specific decision on the appropriateness of attaching antitrust liability.

PE firms should be aware that, if their portfolio companies are drawn into antitrust litigation, they themselves as parents could well be drawn in with them. Although courts are reluctant to pierce the corporate veil, where there is some evidence of the PE parent's direct participation in the alleged conspiracy—even if relatively minor evidence—courts have been willing to allow claims to go past the motion to dismiss stage against the PE parent.

PE parents can give themselves some protection by focusing managerial responsibility with those employees that have a formal executive or director role in the portfolio company, rather than allowing information to flow freely up to the PE level and to employees of the parent that have no official role in the portfolio company. PE parents, like any corporate parent, can also protect themselves and their investment through having a robust antitrust compliance program. In the case of PE firms in particular, investing in thorough antitrust-focused diligence on the front-end—before acquiring the target—can catch existing risks before they become the PE firm's liability.